

SKAGIT COUNTY, WASHINGTON
January 1, 1992 Through December 31, 1992

Schedule Of Findings

1. Inventory Internal Controls For The County Public Works Department Must be Strengthened To Prevent Loss

During our review of the inventory control system of the public works department, we noted the following weaknesses:

- a. Responsibility for the control of inventory has not been fixed. No one can be held accountable for ensuring that inventory is used for proper purposes.
- b. Access to the county public works' inventory is virtually unlimited for public works department employees.
- c. Contractors and other governmental agencies can access the county's rock quarries without county oversight.
- d. During business hours, inventory items are stored in areas where public access is not controlled.
- e. Large, unexplained shortages were identified by our audit between the accounting records of gas and diesel used and the gas and diesel on hand at December 31, 1992. Gas was estimated to be short by approximately 3,000 gallons and diesel by 4,000 gallons.
- f. Lack of control over materials used on job sites, including the lack of procedures to account for inventory not used and subsequently returned to the public works shop.
- g. Comparisons of reconstructed book inventories to the year-end physical inventory resulted in large unexplained differences.
- h. Lack of accounting methods that would prevent or detect loss and allow for accurate, reliable accounting for operational activities.
- i. Lack of written policies covering access to inventory, scrap, keys, and inventory procedures.

RCW 43.09.200 Division of Municipal Corporations) *Uniform System of Accounting*
states in part:

... The accounts shall show the receipt, use and disposition of all public property, and the income, if any, derived therefrom; all sources of public income, and the amounts due and received from each source; all receipts, vouchers, and other documents

kept or required to be kept, necessary to isolate and prove the validity of every transaction (Emphasis added.)

The American Institute of Certified Public Accountants (AICPA) in its *Codification of Statements on Auditing Standards*, AU Section 319, Appendix D, states in part:

Establishing and maintaining an internal control structure is an important management responsibility. In establishing specific internal control structure policies and procedures concerning an entity's ability to record, process, summarize and report financial data that is consistent with management's assertions embodied in the financial statements, some of the specific objectives management may wish to consider include the following:

- Transactions are executed in accordance with management's general or specific authorization.
- Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability of assets.
- Access to assets is permitted only in accordance with management's authorization.
- The recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Access to Assets: The objectives of safeguarding assets requires that access be limited to authorized personnel. In this context, access to assets includes both direct physical and indirect access through the preparation of processing of documents that authorize the use or disposition of assets. Access to assets is required in the normal operations of a business and, therefore, limiting access to authorized personnel is the maximum feasible constraint. The number and competence of personnel to whom access is authorized should be influenced by the nature of the assets and the related susceptibility to loss through errors and irregularities. Limitation of direct access to assets requires appropriate physical segregation and protective equipment or devices. (Emphasis added.)

Management has failed to implement basic accounting controls, making it difficult to hold individual employees responsible or accountable for their own activities. The inventories are not adequately safeguarded to ensure that errors and irregularities are discovered in a timely manner, if at all. When there is no fixed responsibility for the control of these assets, record keeping and theft prevention become secondary endeavors. By failing to implement an adequate internal control system over the inventory, the county is allowing the potential for theft and other abuses to occur undetected.

We recommend that the county restrict access to inventory and fix responsibility for the control of the inventory. Including, but not limited to:

- a. Designate responsibility to a limited number of employees who will be held

accountable for the control of the inventory.

- b. Restrict access to inventory to the limited number of employees referred to in item "a." above. All other individuals should be supervised when in storage areas.
- c. Place all inventory items in limited access areas. These items should be restricted as noted above.
- d. Supervise all gas and diesel deliveries and strictly monitor the issuance of gas and diesel.
- e. Institute controls on all materials charged to jobs. Issue materials to maintenance and other users.
- f. Establish basic inventory accounting controls to control issuance, returns and appropriate use and prevent/detect losses.
- g. Establish written policies concerning access to inventory, scrap, keys, and inventory procedures.

2. The County Public Works Department's Work Order System Needs To Be Strengthened

During our review of the county's work order system we noted that the system is inadequate and needs to be strengthened. Currently, individual employees are responsible for annotating materials used, labor, and equipment hours on their timesheets. While the supervisor approves the timesheet, the date of approval is not recorded and the approval of material charges requires the supervisor to rely on memory for all materials and equipment used. This review does not appear adequate to ensure that these material and equipment costs represent the true and accurate costs for the materials and equipment used for the following reasons:

- a. There is a lack of supporting documentation, such as inventory issue reports, to allow reconciliation of materials issued to materials charged to a job.
- b. Project charges for materials and equipment are not reconciled to materials and equipment records of issues, uses, and returns. Such reconciliation ensures that only materials and equipment actually used are charged to the projects.
- c. The weak controls over inventory noted in Finding 1 also affect the accuracy noted in the work order system.

Subpart C) Post-Award Requirements of the "Common Rule" for *Uniform Administrative Requirements for Grants and Cooperative Agreements To State and Local Governments* prescribed by U.S. Office of Management and Budget (OMB), states in part:

- (a) Fiscal control and accounting procedures . . . must be sufficient to . . .
 - (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes . . .
- (b) . . .
 - (3) . . . Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets . . . and must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

RCW 39.04.070 Public Contracts and Indebtedness) Account and Record of Cost states:

Whenever the state or any municipality shall execute any public work by any means or method other than by contract or small works roster, it shall cause to be kept and preserved a full, true and accurate account and record of the costs of executing such work in accordance with the budgeting, accounting, and reporting system provisions prescribed by law for the state agency or municipality.

The weaknesses noted make it nearly impossible to ensure the completeness, timeliness and accuracy of material charged to a project. As a result of these weaknesses, reimbursement based revenues may be lost through incomplete recording of materials and equipment used. Or, charges for unused materials or equipment may be made to federal,

state or locally funded projects resulting in unallowable costs.

We recommend that the county improve their work order system to provide assurance that charges to a project are timely and accurate.

3. Costs Charged To Federal Projects Should Meet Federal Requirements

Our audit of Skagit County's charges to the Department of Transportation (DOT) disclosed at least \$5,210.90 in charges that are unallowable.

In 1992, Skagit County undertook several projects which were subsequently reimbursed, in part, by Federal Highway Planning and Construction funds. A portion of the work was accomplished using county equipment from the County Equipment Rental Fund and inventory from the Central Stores facility.

The county's policy is to charge each project for equipment usage using a set rental rate. This rate is periodically evaluated by public works staff by taking several factors into consideration including current replacement cost allocated over the expected life of the asset, operations and maintenance costs for the prior year, and the number of hours used in the prior year. The rate is then determined using this calculation as a guide but not as a strict standard. The final rate may be higher or lower for a particular piece of equipment than what the calculation indicates based on management judgment. Historically this rate has been reviewed annually, but in 1992, the 1991 rates were used.

Because the rental rate includes a portion for replacement cost which may or may not be calculated on the same asset life span as depreciation, not all of the equipment rental charges are allowable for federal reimbursement purposes. OMB Circular A-87 *Cost Principles for State and Local Governments* states in part:

Grantees may be compensated for the use of buildings, capital improvements, & equipment through use allowances or depreciation. The computation of depreciation or use allowance will be based on acquisition cost. (Emphasis added.)

Replacement cost is allowable only to the extent of original cost (depreciation). Operational and maintenance costs are allowable only to the extent that they represent actual costs of supplies, labor, and shop operating costs.

Skagit County's general policy in charging out its Central Stores inventory to various projects is to use a standard rate which generally includes not only the cost of the inventory and the operating costs of Central Stores, but also of administrative costs. Accordingly, the county's inventory costs include a portion unattributable to inventory purchase or Central Stores operating costs. OMB Circular A-87 *Cost Principles for State and Local Governments* states in part:

The cost of materials and supplies necessary to carry out the grant programs is allowable . . . Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing consistently applied . . . The cost of maintaining and operating a central stores organization for supplies, equipment, and materials used . . . is allowable.

The county public work's management chose not to adjust the charges to the Highway Planning and Construction grant.

The DOT Highway Planning and Construction grant reimburses different types of expenditures within a project at varying levels. The reimbursements are usually between 83.13 percent and 100 percent of the expenditure type. Audit testing of equipment rental and inventory charges totaling \$28,593.21 to one project resulted in at least \$5,210.90 in

questioned costs. This is the extent of questioned costs for 1992, as this is the only DOT project that had equipment rental and replacement and inventory costs allocated to it.

We recommend that equipment rental and inventory rates be evaluated for allowability within federal guidelines or that project costs be adjusted prior to preparing the reimbursement request using current year allowable rates. We further recommend that Skagit County work with DOT to resolve the unallowable costs identified.

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